

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

AUG 25 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

**In the Matter of**

## Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992

## Rate Regulation

**MM Docket No. 93-215**

**COMMENTS OF DISCOVERY COMMUNICATIONS, INC.**

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Implementation of Sections of )  
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COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

Discovery Communications, Inc. ("Discovery"), by its attorneys, hereby submits its comments on the Commission's Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.<sup>1</sup> As the owner and operator of The Discovery Channel and The Learning Channel, Discovery is not directly subject to rate regulation. However, its business will be affected by the Commission's implementation of the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act").

As Discovery explained in its Petition for Reconsideration of the *Benchmark Order*<sup>2</sup> adopting the benchmark/price cap regulatory regime, most cable operators

<sup>1</sup> FCC 93-353 (released July 16, 1993).

<sup>2</sup> See Report and Order and Further Notice of Proposed Rulemaking, Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, FCC 93-177 (released May 3, 1993) ("*Benchmark Order*"), petitions for reconsideration pending.

who earlier this year were actively interested in carrying The Learning Channel no longer desire to do so. Those limited number of operators who are even willing to *discuss* the addition of new channels are considering significantly new arrangements, including a *la carte* placement. Cable operators have told Discovery that their new position is because of their concerns with the effects of the benchmark/price cap system and that beyond a certain point they see no economic incentive to add program services or to expand the channel capacity of their systems. In essence, Discovery's experience is that, while it was not intended, the market for cable program services has suffered dramatically since the benchmark/price cap rules were announced.<sup>3</sup>

Discovery has made specific recommendations on how to ameliorate this situation in its Petition for Reconsideration in the FCC's benchmark/price-cap proceeding. However, it is also important for the Commission to craft cost-of-service rules in this rulemaking that also promote innovative and diverse cable program services.

Discovery believes that the Commission's NPRM raises three issues of primary concern to video programmers: (1) the

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<sup>3</sup> See Discovery Communications, Inc. Petition for Reconsideration, MM Docket No. 92-266 at 2-3 (filed June 21, 1993). The NPRM states that petitions for reconsideration of the Benchmark Order have been included in the record of this proceeding. NPRM, n.10.

treatment of programming costs; (2) the possible introduction of a productivity factor in the Commission's price-cap model; and (3) the choice of an allocation factor. As explained herein, the public interest requires regulatory provisions which support efforts to bring the American public the best and most diverse video programming possible.

**I. CABLE OPERATORS SHOULD BE ALLOWED TO RECOVER ALL COSTS, INCLUDING AN ADDITIONAL MARGIN, INCURRED IN OBTAINING PROGRAM SERVICES, REGARDLESS OF WHETHER THEY ARE AFFILIATED WITH PROGRAMMERS.**

The 1992 Cable Act has a number of symbiotic policy objectives. Among these are the promotion of investment in the programming area and in modern infrastructure. Without investment in additional capacity, cable systems will be limited as to the amount of programming they can carry. In turn, this obviously will inhibit program development and competition. On the other hand, without additional high quality programming, the need for additional capacity is not as great. This will affect infrastructure investment and fiber-optic manufacturers.<sup>4</sup>

In a cost-of-service model, an incentive exists for investment in modern infrastructure. However, there is no

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<sup>4</sup> See, e.g. Deloitte & Touche, Estimated Impact of Cable Rate Regulation on Cable Television Cash Flows and Capital Expenditures (June 1993), appended to Corning Incorporated and Scientific-Atlanta, Inc. Petition for Reconsideration in MM Docket 92-266.

parallel incentive for programming. This absence of a margin on programming costs will adversely affect the quality and breadth of program services available to consumers. This problem is greatly ameliorated by the *NPRM*'s proposal to treat the cost of programming as an operating expense<sup>5</sup> and to allow cable operators to earn a margin on such programming expenses. Not only would a margin provide cable operators with a direct financial incentive to add new program services, but it would also help to offset the risk they incur in adding program services where the recovery of their investments in such services is not assured. Thus, allowing operators to add a margin on programming would be consistent with the congressional intent in the 1992 Cable Act of promoting consumer welfare.

Discovery is also concerned about the effects of any policy limiting a cable operator's ability to recover true costs of programming, including a margin, for the sole reason of a degree of common ownership or control between the system operator and programmer. In the *NPRM*, a number of proposals are put forth for how to regulate "affiliated" transactions.<sup>6</sup>

As a general matter, Discovery is not convinced that regulations of this nature are required. As Discovery and others have noted, there is no history of this type of abuse

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<sup>5</sup> *NPRM*, ¶ 24 & n.24.

<sup>6</sup> See *NPRM*, ¶¶ 67 - 69.

in the cable industry. The Commission should seriously consider whether it wishes at this time to establish a regulatory program to address a problem in the absence of evidence that it exists. Declining to act at this premature point will not disserve the public interest. If at any time in the future this problem arises, the Commission certainly would have the power to address it promptly and effectively.

If the Commission decides there is a need to adopt regulations of this type, Discovery believes that the proposal in the *NPRM* to require cable operators to record affiliate programming transactions at prevailing company prices offered in the marketplace to third parties is certainly preferable to the arbitrary inflation limitation on pass-throughs of programming costs incurred *vis a vis* affiliated programmers in the benchmark/price cap rules. See *NPRM*, ¶ 68 & n.70.

**II. THE EXISTING FCC REGULATORY MODEL ALREADY HAS PRODUCTIVITY FACTORS BUILT IN AND NO NEED EXISTS FOR AN ADDITIONAL PRODUCTIVITY FACTOR.**

The *NPRM* solicits comment on the desirability of adopting a productivity offset to the GNP-PI inflation adjustment in the price cap mechanism.<sup>7</sup> The *NPRM*, citing the *Benchmark Order*, states that the productivity offset would apply only to non-programming costs incurred by cable

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<sup>7</sup> *NPRM*, ¶ 82.

operators.<sup>8</sup> Discovery strongly agrees with the *NPRM*'s tentative conclusion that as programming costs are exogenous, it would not be appropriate to apply a productivity adjustment to them. Regardless, Discovery is concerned that an unrealistic productivity offset would indirectly affect the programming marketplace adversely.

In evaluating the need for regulations on this point, it is important to remember, as the *NPRM* acknowledges, that the benchmark/price cap regime already incorporates a productivity offset in two respects. First, the benchmark per channel rates decline as the number of channels increases, indicating an increasing productivity.<sup>9</sup> Second, as the *NPRM* states, "the GNP-PI automatically reflects certain productivity gains in the economy."<sup>10</sup> Therefore, the proper issue is not whether a productivity factor should be used, but rather whether an *additional* productivity offset is required at this time. Discovery submits that it is not.

As Discovery stated in its opening comments on rate regulation, insufficient experience and data exist regarding the cable industry upon which a reliable productivity offset

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<sup>8</sup> Order, ¶ 82 & n.93.

<sup>9</sup> *NPRM*, n.93. Thus the benchmark formula implicitly contains a form of programming productivity offset because the per channel rates decline with an increase in the number of channels.

<sup>10</sup> *NPRM*, ¶ 83.

could be established. Unlike in the case of the telephone industry, where the Commission had a long history of rate regulation, the cable industry has neither the history of regulation nor the operational experience on which to measure a productivity adjustment. In the telephone industry, the Commission had the benefit of a substantial economic literature, both published and submitted in the price caps proceeding, on telephone company productivity.<sup>11</sup> In addition, the Commission staff performed two studies of the telephone industry's productivity over significant periods of time: one in the short term since the AT&T divestiture and a long term study of the total telephone industry over a sixty year period. Given the magnitude of the financial consequences of a productivity offset to the cable industry, no less of a record should be developed in this proceeding.

In the absence of comparable data for the cable industry, no productivity offset should be adopted. If in the future a productivity offset is adopted, it should be apply to the GNP-PI inflation factor before the cost of program services is considered, so that programming costs remain exogenous.<sup>12</sup>

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<sup>11</sup> See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, ¶¶ 75-78 & Appendices C & D (1990) ("LEC Price Cap Order").

<sup>12</sup> Of course, a productivity offset is completely inappropriate in a cost-of-service context, where the issue is one of costs, not retail prices.



**III. THE COMMISSION SHOULD NOT ADOPT A COST ALLOCATION FORMULA WHICH DOES NOT TAKE INTO CONSIDERATION IMMINENT TECHNOLOGICAL ADVANCEMENTS.**

The *NPRM* solicits comments on whether the Commission should adopt cost allocation rules beyond those adopted in the *Benchmark Order* to govern the allocation of costs between regulated cable service and unregulated activities in cost-of-service showings.<sup>13</sup> Obviously, the Commission has available a number of regulatory tools to accomplish cost allocations. As Discovery does not operate cable systems, it is not in the best position to comment on which cost allocation methodologies would be most appropriate for the cable industry. However, based on its experience developing Your Choice TV™ ("YCTV"), Discovery can reliably state that the use of any methodology relying on "channels" or channel equivalents as an allocator would be inappropriate.

YCTV is an advanced, satellite-based interactive program packaging and delivery system designed to give consumers the ability to receive and easily interact with a very large number of programming options. Based on highly sophisticated digital compression techniques, as well as on advanced semiconductor manufacturing and computer technology, YCTV will permit virtual video-on-demand. To allow consumers to take advantage of this new environment -- and not just be

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<sup>13</sup> *NPRM*, ¶ 59. The Commission's current rule appears at 47 C.F.R. § 76.924(f). See *Benchmark Order*, Appendix C.

overwhelmed -- specially designed viewer interfaces with programming menus have been created. These will be manipulated by remote control units that will allow subscribers to access their programming options by time, subject matter, etc. The intent is not only to facilitate the emergence of the next generation of cable systems, but to ensure that the emerging multi-choice video environment is user friendly.

In this new world, the concept of a channel is anachronistic. As the Commission recognized when it reviewed the TAT-8 cable application, the concept of bandwidth and channels is not relevant in an era of digital telecommunications and compression techniques.<sup>14</sup> In such an environment the concept of a standard "channel" will be replaced by other concepts, perhaps bit rates received at the television receiver.

Discovery respectfully suggests that reliance on the soon-to-be-antiquated concept of "channels" in any cost allocation formula would disserve the public interest. It is likely that doing so would hinder the development, introduction, and use of new technologies in the cable area. Rather, Discovery urges the Commission to look for allocation

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<sup>14</sup> AT&T, 98 FCC 2d 440 (1984), see also *Through the Looking Glass: Integrated Broadband Networks, Regulatory Policy and Institutional Change*, Robert M. Pepper, OPP Working Paper Series, 24 (November 1988).

methodologies that are consistent with the approaching digital cable environment.

**IV. CONCLUSION.**

For the foregoing reasons, Discovery Communications, Inc., respectfully urges the Commission to ensure that its regulations, both in the benchmark/price cap model and the cost-of-service model, allow cable operators the opportunity to recover their full costs of program services.

Respectfully submitted,

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